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**KENT ECONOMIC
AND DEVELOPMENT
INSTITUTE**

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KEDI ECONOMIC SURVEY

JULY ISSUE

July 31, 1980

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1.0 OVERVIEW AND ASSUMPTIONS

1.01 OVERVIEW

KEDI's projection for the rest of this year shows that the downturn will last until the third quarter. That quarter will be close to being flat as compared to the second quarter. The last quarter will show some increases in the total output of the economy. An upturn will be mild during the first six months of 1981. In the latter part of that year, the upturn will gain momentum, and faster growth will continue during 1982.

In its July budget review, the Administration made some substantial changes from the figures that were used in March. Both sets of information must be viewed in the light of the track record for these projections for the past two years. The Administration's reports have deviated substantially from the actual situation. It is very likely that the current report will keep up that same tradition of being out of the running.

The single largest change made in July concerns the forecast for GNP which the Office of Management and Budget in March had pegged at showing a 0.4 per cent decline when December, 1979, and December, 1980 are compared. Their more recent estimate exceeds 3 per cent. The March

estimate for the gain in consumer prices between the end of last year and the current year was at 12.8 per cent. In July that was cut to an even 12 per cent. That was the only figure that was reduced when the March and July estimates are compared. The calculations for the end of 1981 as compared with the end of 1980 were all increased in the July revision of the Budget Office.

The midyear review that the White House presented was a rather grim one overall. As the reader can see, KEDI projections appear optimistic in comparison, except for price rises in 1981.

Percentage changes, December, 1979

and December, 1980

	<u>Administration</u>	<u>KEDI</u>
GNP	Decline by 3.1	Decline by 1.8
Consumer Prices	Increase by 12	Increase by 11
Unempl. rate, Dec. 1980	8.5	7.7

Percentage changes, December, 1980

and December, 1981

	<u>Administration</u>	<u>KEDI</u>
GNP	Increase by 2.6	Increase by 3.4
Consumer Prices	Increase by 9.8	Increase by 11.6
Unempl. rate, Dec. 1981	8.5	6.7

Some of the released economic news supports the somewhat favorable outlook of KEDI. First, retail sales did increase in June. Secondly, housing starts also went up that month. Thirdly, orders for machine

tools also gained. Fourth, there have been no indications that would point to a dramatic gain in the rate of unemployment in the next few months.

Fifth, the index of consumer confidence put out by the Conference Board moved upward for the first time since last fall. The index gained about 6 points to reach a June level of 48. The index of plans for purchasing autos, housing, and appliances also went up in June. This latter measure rose by 11 to reach above 87. That may be one small bit of good news for U.S. automakers, but not if small foreign cars are the object of the consumer's desire.

Sixth, credit sales have begun to move back again after declining sharply in the response to the credit squeeze of March that the Federal Reserve and the Administration started.

Seventh, in June, the first increase in eight months in the value of construction contracts occurred.

Eighth, the Index of Leading Economic Indicators went up in June. That was the first gain in 12 months. The index in June was 2.5 per cent above the May level. KEDI agrees in principle with Chase Econometrics and other economists that have been saying recently that the worst is over but the downturn will not bottom out completely until late this year. However, many forecasters had been predicting a longer and deeper downturn than this Institute.

Looking ahead a few months holds the potential of presenting an out of focus picture due to the actions of the Federal Reserve. If they move again to tighten credit controls, the downturn will proceed well into next year.

Monetary and credit policy also need to be mentioned here. It is expected by this Institute that such policies will not get any tougher before the end of this year.

At the present time, the majority of forecasters, agree that the economy is at or close to the bottom. They view the fourth quarter of this year as the start of gradual improvement. In terms of a broad overview, KEDI is in agreement.

However, when it comes to specific rates of growth, this Institute is ahead of the pack. Blue Chip Economic Indicators surveyed 40 analysts and found that the average rate of inflation-adjusted GNP forecast for 1981 was a mere 0.5 per cent. Calculations here show that during 1981 GNP will expand by about 1.7 per cent.

Earlier issues of the KEDI Economic Survey did not show an economic downturn quite as clearly as the June and July issues. It has been assumed here that there would be a tax cut this year. That assumption was dropped last month. The Administration is against any tax cut effective during 1980. In late July, Treasury Secretary Miller stressed

the added inflation a tax cut would bring this year. He also noted that cuts to give a boost to the productive section of the economy might be in order in the near future. Such a cut is now seen as much more likely to take effect during 1981.

In summary, this month has brought some good economic news. The economy including the consumer is not performing as badly as many media headlines would have readers believe. There will be a slight upturn starting by the end of this year. Still there is no shortage of specific declines in the economy. These are discussed in the next section.

KEDI forecast is highlighted on the following page.

KEDI FORECAST HIGHLIGHTS

Table 1.0

Indicator	Unit	1978	1979	1980	1985
Gross National Product	bil. const. 72\$	1399.2	1431.7	1420.2	1752.8
Index of Industrial Production	1967 =100	145.2	152.2	146.2	180.1
Capacity Utilization	%	84.3	85.7	79.3	87.2
Unemployment Rate	%	6.0	5.9	7.5	6.0
Private Housing Starts	mil. units	2.020	1.721	1.184	1.956
Car Sales	mil. units	11.3	10.8	8.2	12.8
Implicit GNP Price Deflator	1972 =100	152.1	165.5	180.7	282.0
Consumer Price Index	1967 =100	195.3	217.5	246.7	397.0
Producer Price Index	1967 =100	209.3	236.2	269.2	412.9
Federal Deficit	bil. \$	-27.7	-11.2	-29.6	-16.0
Personal Income	bil. \$	1717.4	1924.2	2112.6	3364.1
Prime Rate	%	9.06	12.76	13.55	10.09
Mortgage Rate	%	9.30	10.60	12.63	10.11
Currency plus Demand Deposits	bil. \$	326.6	363.8	379.4	633.5
Commercial and Industrial Loans	bil. \$	230.9	290.5	308.9	510.4

1.02 ASSUMPTIONS

The following assumptions are part of this forecast. Compared with assumptions incorporated into the June, 1980, forecasts, some changes take place. The forecast data for the third and fourth quarters of 1980 and a part of 1981, have been lowered in real terms. Changes in Assumptions concern the Assumption No. 3.

1. In 1980, approximately 95% of the demand for oil in this country will be met. In 1981 all but basic U.S. demands for oil should be met. The weighted price of oil in 1980 will go up to the \$34 range. In 1981, it is expected the price will go up to \$40, in 1982, to \$46 per barrel, and in 1983, to \$56 per barrel.
2. It is still too current to develop a longer-lasting assumption for the Iranian-Mid East crisis. Compared with the December 1979 forecast, slightly higher price increases of energy items and substantially higher defense orders have been considered.
3. In the summer, no more tightening in fiscal and monetary policies will occur. The Administration and Federal Reserve will ease the conditions in housing and car markets, and for the economy in general. In the last months of this year, some tightening of monetary and fiscal policies is expected.
4. It is assumed that in 1981 the new Administration will adopt a definite program in fighting the inflation. The Federal Reserve Board

will, at long last, begin a policy of setting limits to the monetary growth by long-term commitments, not just short-term as has been the policy in the past. Price and wage controls must remain the last resort of stabilization policy. For 1982 and consecutive years, we assume that the Administration will pursue a more orchestrated anti-inflation policy.

5. Our foreign trade with China will expand more rapidly starting this year, and will gain a substantial momentum in 1981 and following years.

6. In 1981, and 1982 good harvests are assumed for this country and average production of crops is expected in the U.S.S.R. A low harvest in the U.S.S.R. is expected in 1983. The U.S. 1983 harvest will be average, and the years 1984 and 1985 will bring record crops. For this year, the forecast data for some crops, mainly spring wheat, have been reduced somewhat.

7. It is projected here that the rates of growth in 1980-1982 in the major industrial countries will be as follows for real GNP:

	1980	1981	1982
West Germany	3.0%	2.8%	3.1%
Italy	2.1	2.0	2.6
Japan	2.0	2.0	2.3
Great Britain	1.7	1.6	1.9
France	2.0	2.1	2.2

8. Last month the data for the forecast for 1981 and beyond has been changed to include a tax cut of \$30 billion which will take effect in 1981.

1.1 REAL GROWTH

(Table 01. on page 12)

Although there were some signs of improvement in the consumer and foreign trade segments of the economy, the producer segment has not shown any progress. Mixed economic news continues. In June, industrial output was down by a seasonally adjusted 2.4 per cent from the May level. The overall decline in the second quarter was not as sharp as the decline in the recession of 1974-75. Industrial production in June of this year was 7.5 per cent lower than the year earlier figure.

Durable orders were down by 2.8 per cent in June, seasonally adjusted. That was the fifth month of decline, but the drop was the smallest one since February. It was less than half of the rate of fall that had been recorded in May when such orders fell by 7 per cent from the adjusted April level. At least such a rate of decline hasn't proved to be a durable one.

Shipments of durable goods were down by 1.7 per cent in June. Again, that is a much smaller rate of decline than the April-to-May drop of 3.8 per cent. The backlog of orders declines by 1 per cent in June from the prior month.

Factory shipments went down slightly in May from the adjusted April level. These shipments were off by 1.8 billion and reached \$ 141.80 billion in May.

The National Association of Purchasing Management Inc. reported that in their latest survey, the number of companies reporting declines in new orders received was higher than it had been in the past 30 years. Fifty eight per cent of the managers questioned said they received less orders in June than in May. Just 5 per cent of them reported a gain in this area.

Again, there is some positive news in the mixed reports surfacing. In addition to the small list of gains in various sectors mentioned in the Overview section, auto assemblies also showed some increase. That was the first positive change in auto production since February. Auto assemblies went up in June by 7 per cent to an annual rate of 5.9 million units.

Another cheery note can be seen in machine tool orders. These rose by 5.3 per cent in June from the May level, and the gain over June of 1979 was 8.1 per cent. However, those in the industry express the view that such orders will decline some in the next few months as the impact of the downturn curtails demand. Also as factories were operating at 76 per cent of capacity in June, there has not been any need for additional capacity or tools. Even with some upturn, such factories will not have much immediate need for new equipment.

Despite that gain, the decline in factory orders indicate the bottom stage has not yet been reached. First, such orders have to go up, but

it is not until several months later that any gains of that nature create increases in industrial production.

The forecast by this Institute points to a slight upturn in business activity taking place later this fall. No significant improvement in business activity will occur in 1980. During 1981, the recovery will gain some momentum.

In the first half of 1981, some improvements will be experienced in these industries: housing, construction, rubber, appliances, stone and clay products, paper and board, lumber and wood products, apparel, and textiles. Around the middle of 1981, the following industries will begin to recover at a more rapid pace: steel, automobiles, chemicals, plastics and iron ore mining.

There are a few areas that will continue to perform well during the rest of this year and throughout 1981. These are oil, gas, coal, electricity, and most of the machinery industry and aluminum industry. (Energy industry profits are no surprise but the consumers struggling to pay the ever-rising prices may begin to wonder more about it and push for relief.)

In this issue, the forecast has been reduced for the harvest this year. Making hay while the sun shines will be curtailed a bit by farmers as the very hot and dry weather has taken its toll. The projection for corn has been cut by 7 per cent, hay by 3 per cent, tobacco by 5 per cent, and spring wheat by 6 per cent.

TABLE 01. REAL GROWTH
(Unless otherwise noted, quarterly data
are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1	2	3	4	
Gross National Product, 1972\$	bil.\$	1431.7	1444.7	1410.8	1408.5	1416.9	1420.2
Index of Indust. Production	1967=100	152.2	152.1	144.7	143.1	145.0	146.2
Unemployment Rate	%	5.9	6.1	7.5	8.2	8.0	7.5
Capacity Utilization Rate	%	85.7	85.1	77.2	76.8	78.1	79.3
Private Housing Starts	mil. units	1,721	1,330	1,048	1,149	1,211	1,184
Car Sales	mil. units	10.8	9.5	7.7	7.9	7.6	8.2
Indicator	Unit	1980	1981				1981
			1	2	3	4	
Gross National Product, 1972\$	bil.\$	1420.2	1425.7	1436.7	1451.2	1465.3	1444.7
Index of Indust. Production	1967=100	146.7	146.9	148.7	152.1	154.3	150.5
Unemployment Rate	%	7.5	7.7	7.2	7.1	6.6	7.1
Capacity Utilization Rate	%	79.3	79.8	81.5	84.2	85.0	82.6
Private Housing Starts	mil. units	1,184	1,144	1,330	1,530	1,495	1,374
Car sales	mil. units	8.2	9.0	10.1	10.4	10.6	10.0
Indicator	Unit	1981	1982				1982
			1	2	3	4	
Gross National Product, 1972\$	bil.\$	1444.7	1477.5	1494.7	1512.6	1520.3	1501.3
Index of Indust. Production	1967=100	150.5	156.0	157.8	159.5	160.9	158.6
Unemployment Rate	%	7.1	6.6	6.4	6.1	6.0	6.2
Capacity Utilization Rate	%	82.6	86.0	86.3	86.5	86.4	86.3
Private Housing Starts	mil. units	1,358	1,400	1,603	1,642	1,644	1,572
Car sales	mil. units	10.0	10.1	11.1	10.8	11.3	10.8

* Historical Data

The forecast for winter wheat, though, has been increased by 10 per cent.

1.2 PRICES AND NOMINAL GNP
(Table 02, on page 15)

Some price projections in this issue have been changed slightly.

This is due mainly to revised data in the index of producer prices.

In June, the producer price index for finished goods went up by 0.8 per cent, seasonally adjusted, from the May level. For the second quarter such prices gained at a much lower rate than had been experienced in the first quarter.

KEDI projects an 11 per cent gain in consumer prices during this year and in 1981. The increase in 1982 as compared to 1981 will be at the slightly lower rate of 10 per cent.

This is roughly in line with the majority of forecasters. For instance, Data Resources predicts the consumer price index will go up by 11.5 per cent this year and 9.1 during 1981. Chase Econometrics predicts such prices will gain by 12.9 per cent this year and 9.7 per cent next year.

Consumer prices in June rose at an adjusted rate of 1 per cent. That was above the May rate of 0.9 but much lower than the 1.4 per cent monthly average in the first quarter. During July and August, this Institute expects that consumer price gains will slow to close to a 10 per cent annual rate. In the fall, there will be a resumption of the

upward trend in this area. The main reasons for the acceleration at that time will be the gains in the prices of food items and imported goods. Producers' prices will increase at a faster rate in these months also.

The damage caused by the heat and dry weather in much of the United States has been affecting crops, cattle, and chickens. Consumers will pay for the cut in supplies in the grocery stores as middlemen continue to make profits.

The forecast by this Institute shows the current downturn (which was largely initiated by the Administration's action in March of this year) will not result in any desirable lessening in the rate of gains in prices. In the 1974-75 recession, the rate of inflation was reduced to an annual rate of 5 per cent. The current downturn will not end up with such a relatively low rate. Inflation of 10 per cent is much more likely. The harsh manipulation of interest rates earlier this year contributed to the resistance of the inflation rate to any severe cuts.

The question is raised as to the effectiveness of trying to use a downturn as a weapon to fight inflation. Calculations here show that low productivity of labor and ever increasing costs of labor plus excesses and inefficiencies of the government are the main causes of inflation.

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TABLE 02. PRICES AND NOMINAL GNP
(Unless otherwise noted, quarterly data
are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1	2	3	4	
Consumer Price Index, NSA	1967=100	217.5	236.6	245.0	249.1	255.9	246.7
Producer Price Index, NSA	1967=100	236.2	258.7	263.7	271.9	282.6	269.2
Implicit GNP Price Deflator	1972=100	165.5	174.5	178.9	182.5	186.7	180.7
Gross National Product	bil.\$	2369.5	2520.8	2523.4	2570.5	2645.4	2565.0
Personal Cons. Expenditures	bil.\$	1510.0	1629.5	1628.2	1671.3	1722.1	1662.8
Gross Private Dom. Investment	bil.\$	387.3	387.7	365.9	380.2	390.4	381.3
Indicator	Unit	1980	1981				1981
			1	2	3	4	
Consumer Price Index, NSA	1967=100	246.7	260.1	269.6	277.6	282.2	272.6
Producer Price Index, NSA	1967=100	269.2	290.4	296.7	300.8	307.7	298.9
Implicit GNP Price Deflator	1972=100	180.7	190.2	195.2	200.9	206.4	198.2
Gross National Product	bil.\$	2565.0	2711.7	2804.4	2903.7	3024.4	2861.1
Personal Cons. Expenditures	bil.\$	1662.8	1785.3	1852.4	1922.1	2010.5	1892.6
Gross Private Dom. Investment	bil.\$	381.3	399.2	409.1	421.5	439.6	417.4
Indicator	Unit	1981	1982				1982
			1	2	3	4	
Consumer Price Index, NSA	1967=100	272.6	290.4	297.8	302.9	308.2	299.8
Producer Price Index, NSA	1967=100	298.9	320.5	324.1	326.0	330.3	325.2
Implicit GNP Price Deflator	1972=100	198.2	208.0	212.2	216.3	220.4	214.2
Gross National Product	bil.\$	2861.1	3073.2	3171.8	3271.8	3350.7	3216.9
Personal Cons. Expenditures	bil.\$	1892.6	2041.6	2121.2	2182.0	2234.6	2144.9
Gross Private Dom. Investment	bil.\$	417.4	443.7	451.0	464.7	478.7	459.5

* Historical Data

1.3 EMPLOYMENT AND LABOR
(Table 03. on page 17)

In June, the unemployment rate went down a bit to 7.7 per cent from the May level of 7.8. The July rate is expected to be just slightly above the June rate.

The KEDI forecast is optimistic when compared to projections of many forecasters. In the coming months, most of them expect that unemployment will rise substantially. Even the Administration's forecast calls for an unemployment rate of 8.5 per cent at the end of this year. They expect it will remain at roughly the same level throughout 1981.

This Institute's forecast is contained in Table 03. on the following page. The table shows a rate of 8.0 for unemployment in the fourth quarter of 1980 and consecutive declines during 1981.

More significant declines in this rate are expected during the second half of 1981. The projection show at that time most workers in the steel, rubber, construction, and chemical industries will be back at work. It is also forecast here that in the auto industry approximately 95 per cent employment will exist. Such recovery will be largely due to U.S. cars finally being competitive with the smaller and more fuel efficient imports.

During the second quarter of this year, labor productivity again fell-- this time at an annual rate of 3.1 per cent. That makes six quarters

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TABLE 03. EMPLOYMENT AND LABOR
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1 *	2	3	4	
Population	mil.	220.4	221.9	222.6	223.4	224.1	223.0
Civilian	mil.	103.3	104.2	104.7	105.2	106.0	105.0
Labor Force	mil.						
Employed	mil.	97.2	97.8	96.9	96.6	97.5	97.2
-Agriculture	mil.	3.3	3.3	3.4	3.4	3.3	3.4
-Non Agriculture	mil.	93.9	94.5	93.5	93.2	94.2	93.8
Unemployment	%	5.80	6.13	7.46	8.18	8.01	7.45
Rate							
Indicator	Unit	1980	1981				1981
			1	2	3	4	
Population	mil.	223.0	224.7	225.5	226.3	227.1	225.9
Civilian	mil.	105.0	106.6	107.0	107.8	108.5	107.5
Labor Force	mil.						
Employed	mil.	97.2	98.4	99.3	100.2	101.3	99.8
-Agriculture	mil.	3.4	3.3	3.3	3.4	3.3	3.3
-Non Agriculture	mil.	93.8	95.1	96.0	96.8	98.0	96.5
Unemployment	%	7.45	7.69	7.17	7.05	6.60	7.13
Rate							
Indicator	Unit	1981	1982				1982
			1	2	3	4	
Population	mil.	225.9	228.0	229.2	230.4	231.3	229.7
Civilian	mil.	107.5	109.1	109.9	110.7	111.6	110.3
Labor Force	mil.						
Employed	mil.	99.8	101.9	102.9	104.0	104.9	103.4
-Agriculture	mil.	3.3	3.3	3.4	3.4	3.3	3.4
-Non Agriculture	mil.	96.5	98.6	99.5	100.5	101.6	100.0
Unemployment	%	7.13	6.58	6.37	6.05	5.97	6.24
Rate							

*Historical Data

in a row of such declines. There has been no growth to speak of in productivity since 1976. (That bicentennial year should have seen the start of better things.) Declining rates here add fuel to the inflation rate because rising wage rates are not able to be offset by any increased efficiency by the worker. Of course, management, equipment, and incentives or the lack of them are involved here.

The U.S. has provided poor productivity performance, particularly (tongue twister intended) since 1976 but starting back in the middle 60's. Labor costs will continue to increase sharply in the coming years due to the escalator clauses in wage settlements. Such clauses cover almost one-half of all employees in U.S. industry. (The other one-half may find some means of getting raises in the attempts at economic survival in the face of steadily declining real income to spend.)

The KEDI forecast shows that there will be some increases in productivity but not before 1983. It should show gradual gains after that for a few years.

1.4 HOUSING

(Table 04. on page 19)

The present forecast for housing starts has been adjusted slightly upwards, due to the leap in housing starts, housing sales, and building permits in June. KEDI had been expecting some strength to show up here, but not quite as much as the June data revealed.

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TABLE 04. HOUSING
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1	2	3	4	
Single-Family Housing Starts	mil. units	1,169	801	669	684	691	711
Multifamily Housing Starts	mil. units	.551	529	379	465	520	473
Mobile Homes Shipments	thous units	283	257	182	189	201	207
Housing Permits Issued	mil. units	1,535	965	885	1005	989	961
Construction Costs-Commerc.	1972= 100	180.2	193.5	197.0	199.1	202.3	198.0
Construction Costs-Resident.	1972= 100	178.8	192.1	196.4	199.0	205.1	198.2
Indicator	Unit	1980	1981				1981
			1	2	3	4	
Single-Family Housing Starts	mil. units	711	728	772	936	894	832
Multifamily Housing Starts	mil. units	473	416	558	594	601	542
Mobile Homes Shipments	thous units	207	227	260	268	280	259
Housing Permits Issued	mil. units	961	976	1178	1349	1390	1223
Construction Costs-Commerc.	1972= 100	198.0	209.1	215.9	219.4	228.4	218.2
Construction Costs-Resident.	1972= 100	198.2	210.0	216.2	218.7	225.8	217.9
Indicator	Unit	1981	1982				1982
			1	2	3	4	
Single-Family Housing Starts	mil. units	832	850	962	1010	990	953
Multifamily Housing Starts	mil. units	542	550	641	632	654	619
Mobile Homes Shipments	thous units	259	275	298	304	297	294
Housing Permits Issued	mil. units	1223	1294	1576	1680	1701	1563
Construction Costs-Commerc.	1972= 100	218.2	238.5	247.6	255.7	263.9	251.4
Construction Costs-Resident.	1972= 100	217.9	237.9	248.7	254.8	265.6	251.2

* Historical Data

Single-family home starts went up by 18.9 per cent in June. Still, the rate was about 41 per cent below the rate one year earlier. Multi-family housing construction went up by 55.8 per cent in June. That rate was 30 per cent behind the rate in June of 1979.

This Institute's forecast shows housing starts will attain a level of 1,184 million units in 1980. That is still approximately 31 per cent below the total for last year. One of the main problems affecting any faster recovery is the stock of new, unsold houses. In June, it was estimated that there was an 8.8 month supply of new houses for sale at the end of May. Some price cutting has helped. In May the median price for a new home went down to \$62,600 from the April level of \$63,000 and the year-earlier level of \$62,800.

New home sales were also aided by the fall in mortgage rates. In May, sales of new homes leaped ahead by 39.4 per cent from the April level. All the sales gains were in the South and West. On a year-to-year comparison, the national sales rate was still down 31.5 per cent.

The forecast concerning shipments of mobile homes has been adjusted downward. An upward adjustment has been made in the cost of housing.

1.5 BUDGETS

(Table 05. on page 22)

The Administration has finally abandoned the budget-balancing charade. They have admitted at last, that there will be a deficit in fiscal 1981,

and it will amount to \$29.8 billion from receipts of \$604 billion and expenditures of \$633.8 billion. (It was only March when government statements were made about the \$16.5 billion surplus they anticipated.)

This Institute has always been sceptical of the balanced budget publicity. It was not to be believed here. A balanced budget was never incorporated in the assumptions or in the actual forecast.

Starting in 1977 (see, for example, the August, 1977, issue of the KEDI survey, page 3, and following issues), KEDI has built a 1981 tax cut into its assumptions. Indications now are that the tax cut will be enacted in the early part of next year.

Calculations here show that the tax burden will increase by approximately \$50 billion in 1981 as compared to this year. That will have to be paid by consumers and businesses. Then the cut of \$30 billion will not actually be a tax cut, but a CUTBACK in tax increases. Such estimates are roughly in line with Professor Walter Heller, formerly of the Council of Economic Advisors. He calculated that a small tax cut, about \$30 billion, is actually a \$30 billion reduction in the \$60 billion tax increase likely next year. That amount, according to Professor Heller, comes from \$27 billion in increased oil profits tax revenue, \$14 billion in "bracket creep" in income taxes, and about \$18 billion in new payroll taxes. Estimates here differ as to the payroll tax gain which KEDI calculates will be roughly \$8 billion, hence the \$50 billion figure mentioned at

TABLE 05. FEDERAL AND STATE
AND LOCAL BUDGETS
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1	2	3	4	
<u>Federal Govt.:</u>							
Income Taxes	bil.\$	225.0	239.9	242.6	246.0	250.3	244.7
Corporate Profit	bil.\$	78.5	86.8	84.8	85.2	87.3	86.0
Tax Accruals	bil.\$	-11.2	-22.9	-26.8	-33.4	-35.2	-29.6
Surpl./Deficit	bil.\$						
<u>State and Local Governments:</u>							
Income Taxes	bil.\$	40.7	39.7	40.0	40.8	42.0	40.6
Corporate Profit	bil.\$	14.4	15.6	15.2	15.1	16.2	15.5
Tax Accruals	bil.\$	24.7	24.6	24.0	22.7	23.0	23.6
Surpl./Deficit	bil.\$						
Indicator	Unit	1980	1981				1981
			1	2	3	4	
<u>Federal Govt.:</u>							
Income Taxes	bil.\$	244.7	265.1	276.4	284.8	297.3	280.4
Corporate Profit	bil.\$	86.0	90.9	94.0	96.5	99.7	95.3
Tax Accruals	bil.\$	-29.6	-39.5	-46.8	-49.8	-45.4	-45.4
Surpl./Deficit	bil.\$						
<u>State and Local Governments:</u>							
Income Taxes	bil.\$	40.6	43.5	45.2	46.9	48.4	46.0
Corporate Profit	bil.\$	15.5	17.0	18.9	21.4	22.0	19.8
Tax Accruals	bil.\$	23.6	24.0	25.7	27.2	28.3	26.3
Surpl./Deficit	bil.\$						
Indicator	Unit	1981	1982				1982
			1	2	3	4	
<u>Federal Govt.:</u>							
Income Taxes	bil.\$	280.4	310.2	320.1	328.7	332.1	322.8
Corporate Profit	bil.\$	95.3	103.6	108.9	116.9	121.8	112.8
Tax Accruals	bil.\$	-45.2	-32.1	-28.7	-24.6	-22.8	-21.8
Surpl./Deficit	bil.\$						
<u>State and Local Governments:</u>							
Income Taxes	bil.\$	46.0	49.7	50.3	52.8	54.9	51.9
Corporate Profit	bil.\$	19.8	23.0	24.4	25.9	27.3	25.2
Tax Accruals	bil.\$	26.3	28.8	30.4	32.0	33.0	31.1
Surpl./Deficit	bil.\$						

* Historical Data

the start of this paragraph as the tax increase in receipts likely.

The new KEDI projection of the Federal Budget shows a sharp gain in the deficit for both 1981 and 1982 calendar years. Originally, the forecast here was for \$26.4 billion and \$14.8 billion, respectively. Now the prediction shows a \$45.4 billion deficit for 1981 and \$21.8 in 1982. The deficit in 1981 is due mainly to the tax cut and larger unemployment benefits payments than previously anticipated.

As compared with the previous issue, no substantial change has taken place in the calculations for State and Local Budgets.

There is an agreement here (except for calling the downturn a recession) with the following quote from Professor Heller in the Wall Street Journal on June 30, 1980.

...we are in the midst of a recession induced by tough fiscal and monetary policy--an election-year recession induced to fight inflation. Surely, that violates all the political cliches about years divisible by four.

1.6 INCOME

(Table 06. on page 24)

The forecast here for after-tax corporate profits is somewhat lower than what had appeared in the last issue. Instead of a projected decline of 1.2 per cent in the second quarter of 1980 as compared to the first quarter, the drop is now seen as being in the 3 per cent range. For the third quarter, the new projection shows an additional drop of

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TABLE 06. INCOME
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1	2	3	4	
Personal Income	bil.\$	1924.2	2057.4	2078.3	2119.1	2195.4	2112.6
Personal Dispos. Income	bil.\$	1624.1	1737.4	1754.0	1760.3	1799.7	1762.9
Compensation of Employees	bil.\$	1459.5	1555.2	1566.1	1576.9	1640.8	1578.8
Corp. Profits After Tax	bil.\$	144.6	158.0	153.4	146.2	149.7	151.8
Personal Saving	bil.\$	73.2	64.4	82.9	80.5	81.7	77.4
Average Weekly Earnings	\$	218.7	225.2	225.1	228.3	230.6	227.1
Indicator	Unit	19 80	1981				1981
			1	2	3	4	
Personal Income	bil.\$	2112.6	2251.6	2320.8	2386.9	2450.6	2352.5
Personal Dispos. Income	bil.\$	1762.9	1827.5	1876.3	2025.7	3034.5	2191.0
Compensation of Employees	bil.\$	1584.8	1695.7	1761.4	1828.7	1894.9	1795.2
Corp. Profits After Tax	bil.\$	151.8	158.7	165.4	172.3	175.7	168.0
Personal Saving	bil.\$	77.4	81.3	82.6	83.1	81.6	82.2
Average Weekly Earnings	\$	227.1	232.4	236.0	238.1	240.5	236.8
Indicator	Unit	1981	1982				1982
			1	2	3	4	
Personal Income	bil.\$	2352.5	2501.7	2560.7	2628.1	2700.3	2597.7
Personal Dispos. Income	bil.\$	2191.0	2138.2	2181.4	2245.0	2301.5	2216.5
Compensation of Employees	bil.\$	1795.2	1966.7	2021.5	2073.5	2109.7	2042.9
Corp. Profits After Tax	bil.\$	168.0	178.1	180.2	182.6	184.0	181.2
Personal Saving	bil.\$	82.2	83.5	88.4	89.0	90.1	87.8
Average Weekly Earnings	\$	236.8	243.1	247.8	251.6	256.8	249.8

* Historical Data

5 per cent when compared with the projected second quarter. There will be some increase in the fourth quarter.

Calculations here show that the main declines will be in losses of the automobile makers, steel producers, chemical and plastics, and aircraft companies. On the other hand, good profit results are expected in oil, electricity, banking, communications, food, machinery (especially electrical), and electronics.

The KEDI projection concerning profits is more optimistic than those of some other forecasters. It is not felt here that profits will drop by 18 or 20 per cent in the third quarter and drop further in the last quarter. Nor is it foreseen here that profits over the course of the downturn will drop by as much as 23 per cent. As can be seen from data in Table 06., after tax profits will be \$146,2 billion in the third quarter and will go up to \$149,7 billion in the fourth quarter.

The projection here for personal income and its components remains basically unchanged. The data for employee compensation has been reduced somewhat due to a small increase in the projection of the number of unemployed.

1.7 MONEY AND CREDIT

(Table 07. on page 27)

The June data for monetary aggregates and preliminary data the first half of July show sharper gains in the money supply. For example, in

June the basic money supply, M1-A jumped ahead at an annual rate of 11.4 per cent. It had declined during the first five months of this year.

In June, M-2, which includes savings deposits and is a broader measure, grew at an annual rate of 17.1 per cent. That brought its growth rate for the first half of this year to 7.6 per cent which is within the target range of the Federal Reserve.

Commercial and industrial loans were up. There had been some declines in June, but in the week ending July 2, such loans moved up by \$1.22 billion to total over \$154.28 billion.

However, the future growth of monetary aggregate and loans will critically depend on the policy of the Federal Reserve; if it will start tightening the policy again, we can expect that the rest of the year will be flat both for monetary aggregates and loans. The forecast by KEDI for this year shows that M1-A will grow by 4.3 per cent. In 1981, it will expand by 8.1 per cent. This year, M-2 is seen increasing by 6.8 per cent. Next year that growth is projected at 8.1 per cent.

Compared with recently released Federal Reserve targets for monetary growth, this Institute's figures are higher. The Federal Reserve growth target for M1-A in 1981 is in the 3 to 5.5 per cent range. For M-2, the growth target they have is 5.5 to 8.5 per cent which is a bit lower than the 1980 range of 6 to 9 per cent. The target for M-3 will

TABLE 07. MONEY AND CREDIT
(Data for "Currency + Demand Deposits" and "Time Deposits, Adjusted"
are averages of daily figures; other data are end of period figures)

Indicator	Unit	1979*	1980				1980
			1	2	3	4	
Currency+Demand Deposits	bil.\$	363.8	374.8	371.2	382.3	389.6	379.4
Time Deposits, Adjusted	bil.\$	1471.4	1543.6	1570.1	1590.3	1612.4	1578.9
Consumer Instal. Credit	bil.\$	311.1	307.6	301.1	302.4	306.7	306.7
Commerc.and Ind. Loans at Banks	bil.\$	290.5	302.7	301.7	303.2	308.9	308.9
Negotiable Cert.of Deposits	bil.\$	115.6	117.2	121.4	122.8	128.5	128.5
Mortgages at S&L Assns.	bil.\$	475.8	479.3	479.1	480.2	485.3	485.3
Indicator	Unit	1980	1981				1981
			1	2	3	4	
Currency+Demand Deposits	bil.\$	379.4	394.9	406.2	413.8	417.6	408.1
Time Deposits, Adjusted	bil.\$	1578.9	1670.2	1699.7	1726.5	1730.3	1706.7
Consumer Instal. Credit	bil.\$	306.7	309.8	313.0	315.9	321.6	321.6
Commerc.and Ind. Loans at Banks	bil.\$	308.9	314.6	318.7	324.2	327.6	327.6
Negotiable Cert.of Deposits	bil.\$	128.5	131.3	134.7	136.3	140.2	140.2
Mortgages at S&L Assns.	bil.\$	485.3	491.6	504.8	511.9	518.7	518.7
Indicator	Unit	1981	1982				1982
			1	2	3	4	
Currency+Demand Deposits	bil.\$	408.1	421.5	426.8	432.8	440.7	430.5
Time Deposits, Adjusted	bil.\$	1706.7	1732.5	1748.7	1762.7	1785.3	1757.3
Consumer Instal. Credit	bil.\$	321.6	326.8	330.7	337.8	344.8	344.8
Commerc.and Ind. Loans at Banks	bil.\$	327.6	330.4	335.8	338.2	343.1	343.1
Negotiable Cert.of Deposits	bil.\$	140.2	145.1	148.7	153.6	158.9	158.9
Mortgages at S&L Assn.	bil.\$	518.7	529.3	542.6	561.4	573.2	573.2

* Historical Data

remain at the 1980 rate of 6.5 to 9.5 per cent. Bank credit also has the same target next year as this; namely, 6 to 9 per cent. In general, the idea of the Federal Reserve is one of reducing money supply targets by about 0.5 per cent next year.

At the present time, that seems to indicate the continued pursuit of a restrictive monetary policy this year and in 1981. Chairman Paul Volcker said in late July that tax and spending policies should have the same restraint as the Federal Reserve does with monetary policy. His testimony before Congress gave the message that he does not want to risk greater inflation in any attempts to strengthen the economy.

It is the position at KEDI that the growth rates set by the Federal Reserve are TOO LOW. If **followed**, they will again contribute to the slowdown in the growth of the economy just when it will be starting to rebound from the slump.

1.8 INTEREST RATES

(Table 08. on page 30)

KEDI's prediction for short-term interest rates is as follows: the rates will gradually decline for a short time. In the last months of the year, they will resume the upwards trend. This Institute sees, for example, the prime rate bottoming at 10.5%, and its year end rate at 11.0%.

For long-term interest rates, KEDI's prediction is that they already

have reached the bottom. A gradual trend will take place soon.

The Federal Reserve is in an awkward position. On July 27, it had to decrease its discount rate from 11 to 10 per cent to avoid the unnatural situation of the prime rate and many of short-term rates slipping below the Federal discount rate. If the short-term rates continue declining, then the Federal discount rate will have to be decreased again -- and that would undermine the international position of the dollar.

It is the assumption of this Institute, that in the near future the Federal Reserve has to resume the pursuit of some sort of restrictive policy concerning higher interest rates. Indications are, that foreign countries will not follow the American lead in reducing interest rates. The gap between the U.S. and foreign interest rates is widening. Calculations show, that if the Federal Reserve again lowers its discount rate, and foreign interest rates do not move downwards, then that move will push down the dollar rate of exchange from about 1.7 German Marks to 1.5; the English pound from \$2.2 to 2.5, and the Swiss franc from \$1.6 to 1.4, with all the accompanying inflationary consequences.

From the point of view expressed in the preceeding paragraphs, the prediction of many forecasters about the prime rate falling below 10 per cent in the coming months seems to be overly optimistic. Some economists with investment concerns have been saying that the prime rate will fall to 10 per cent or less by October. Others indicate

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TABLE 08. INTEREST RATES, YIELDS
AND SECURITIES PRICES

Indicator	Unit	1979*	1980				1980
			1	2	3	4	
3 mo Treas.Bills Rate(new issues)	%	10.19	13.35	9.97	9.04	9.63	10.50
Prime Rate	%	12.76	16.39	15.74	11.06	11.02	13.55
Mortgage Rate, New Homes	%	10.60	15.23	12.27	11.89	11.14	12.63
Aaa Bonds Rate	%	9.63	12.14	11.05	10.83	10.91	11.23
Long Term Govt. Bonds Yield	%	9.33	11.78	10.71	10.54	10.59	10.81
Standard & Poor's 500 Average	1941- 43=100	102.83	110.30	108.40	105.31	101.26	106.32
Indicator	Unit	1980	1981				1981
			1	2	3	4	
3 mo Treas.Bills Rate(new issues)	%	10.50	9.81	10.12	10.31	10.06	10.08
Prime Rate	%	13.55	11.14	11.24	11.53	11.93	11.46
Mortgage Rate, New Homes	%	12.63	11.26	11.28	11.50	11.53	11.39
Aaa Bonds Rate	%	11.23	10.26	10.95	10.63	11.26	11.75
Long Term Govt. Bonds Yield	%	10.81	10.24	10.28	10.40	10.62	10.39
Standard & Poor's 500 Average	1941- 43=100	106.32	103.45	104.06	108.84	111.24	106.98
Indicator	Unit	1981	1982				1982
			1	2	3	4	
3 mo Treas.Bills Rate(new issues)	%	10.08	10.24	11.03	11.51	11.76	11.14
Prime Rate	%	11.46	11.37	11.02	11.24	12.06	11.42
Mortgage Rate, New Homes	%	11.39	11.17	11.36	10.80	10.24	10.89
Aaa Bonds Rate	%	11.75	11.02	10.76	10.20	10.01	10.50
Long Term Govt. Bonds Yield	%	10.38	10.31	10.25	10.32	10.45	10.33
Standard & Poor's 500 Average	1941- 43=100	106.98	102.34	100.41	105.26	112.14	105.04

* Historical Data

that 10 per cent would be the lowest rate in September. Some in the banking industry pointed to the year end as being when the low point will be reached. The chief economist with Manufacturers Hanover Trust Co., said that the rate would be lower than 10 per cent by the end of August and down to the 8½ per cent range by the end of the year.

Other economists are more cautious. For instance, chief economists for Equitable Life Assurance Society forecast that there would be very little downward change in long term rates and that by early 1981 short terms rates would begin to increase again.

An investment brokerage firm official indicated that the prime rate would likely fall to the 10 or 10½ per cent range by the end of September and go a bit below that during the fourth quarter. However, he did not expect it would go lower than 9½ per cent this year.

As was stated earlier, KEDI predicts the lowest point of the prime rate to be 10.5 per cent.

2.0 COMPARISONS OF ACCURACY OF PREDICTIONS

In this issue, GNP in current dollars for the second quarter 1980 has been selected for comparison. Actual data have been communicated by the U.S. Department of Commerce, Bureau of Economic Analysis.

Forecast data are from Business Forecasts 1980, published by the Federal

Reserve Bank of Richmond, Va., February 1980, Library of Congress

Catalogue Card No: 75-189493. The table below shows the predictions of forecasters and the deviations of forecast data.

Table 2.0 COMPARISONS OF ACCURACY OF PREDICTIONS

GROSS NATIONAL PRODUCT

(in billion dollars, seasonally adjusted
at annual rates, 2nd quarter 1980)

Actual: 2523.4

FORECASTER	<u>Page in</u> <u>Business</u> <u>Forecasts</u> <u>1980</u>	<u>Forecast</u>	<u>% of</u> <u>Accuracy</u>
<u>Level:</u>			
Manufacturers Hanover Trust	20	2501.5	-.9
Chemical Bank	21	2535.1	+.5
The First National Bank of Chicago	22	2493.0	-1.2
Median Forecasts of Business	23	2497.0	-1.1
Georgia State University	24	2491.4	-1.3
Peter L. Bernstein, Inc.	25	2521.0	-.1
The UCLA National Business Forecast	26	2484.2	-1.6
Cyrus J. Lawrence Incorporated	27	2486.8	-1.5
Bankers Trust Company	28	2505.5	-.8
Goldman Sachs	29	2545.0	+.8
The Fidelity Bank	30	2538.0	+.5
<u>KEDI</u>	31	2522.8	.0
U.S. News and World Report	32	2463.3	-3.4
Data Resources, Inc.	33	2540.5	.7
Equitable Life Assurance Society	34	2526.9	+.1
Morgan Guaranty Trust Company	35	2519.7	-.2
Argus Research Corporation	36	2496.7	-1.1